THE TCC OPENS THE DOOR (SLIGHTLY) FOR ADJUDICATION PROCEEDINGS BY COMPANIES IN LIQUIDATION

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A recent TCC decision has provided further guidance on a liquidator's options when seeking payments owed to insolvent companies through adjudication and the interplay with the Insolvency Rules. The decision establishes an exception to the general principle that such adjudication proceedings will not be enforced (and are liable to be injuncted) where the responding party has a cross-claim. The exception focuses on the provision of adequate security by the company in liquidation and the absence of any abuse of process where such claims are to be pursued by third parties on the liquidator's behalf in exchange for a share of the proceeds.

Adjudication proceedings by companies in liquidation: a recap of the current position

Under the Insolvency (England and Wales) Rules 2016 (the "Insolvency Rules"), a mandatory set-off takes effect upon a company's entry into liquidation. The set-off applies where there have been mutual dealings between the company and a creditor. The effect of the rule is to net-off those dealings so that only the balance is provable in the liquidation.

The rule is an exception to the *pari passu* principle (i.e. equal treatment) as the set-off provides the creditor with a full recovery of part of its claim. Without the rule, the creditor would be obliged to make full payment of any amounts owed to the company, whilst only being able prove in the liquidation for its own claims. If the dividend from the liquidation is small, the creditor could well be required to pay more into the liquidation than it would receive in return despite the fact that its claims against the company exceed the company's claims against it.

Insolvency set-off takes place automatically upon liquidation and overrides all other set-offs or contract terms to the contrary. In addition, the parties cannot contract out of insolvency set-off nor waive its operation.

The interaction between the Insolvency Rules and construction adjudication was considered recently by the TCC in *Lonsdale v Bresco* and then on appeal. Please see our Law Nows available here and here for more detail on those decisions. In summary, the TCC initially held that mandatory set-off under the Insolvency Rules deprived an adjudicator of any jurisdiction to determine disputes under a construction contract involving the company in liquidation. The Court of Appeal overruled this finding, considering that adjudications could still be validly commenced by companies in liquidation, but agreed that there was a basic incompatibility between adjudication and the Insolvency Rules. This was reflected in previous cases which have held that the court will not, save in exceptional circumstances, enforce adjudication decisions in favour of companies in liquidation where the responding party has a cross-claim. To do so would force the responding party to pay the amount of the adjudication decision, while being left to prove in the liquidation for its cross claim

and receive only a partial recovery together with other unsecured creditors. In such circumstances the responding party would be deprived of the benefit it was intended to have through the mandatory set-off under the Insolvency Rules.

The upshot of the Court of Appeal's decision was that, save for exceptional circumstances, an adjudication by a company in liquidation would be liable to be stopped by the court as an exercise in futility where the other party has a cross-claim (i.e. because any adjudication decision would not be enforced). A recent decision of the TCC has now considered what exceptional circumstances might justify the enforcement of adjudication proceedings by a company in liquidation in such circumstances.

Meadowside Building Developments Ltd (in Liquidation) v 12-18 Hill Street Management Company Ltd

Meadowside was appointed by 12-18 Hill Street Management Company ("Hill") to carry out repair works and practical completion was certified in March 2015. In July 2015, Meadowside was wound up voluntarily.

Meadowside's liquidators had engaged Pythagoras Capital Limited as agent to seek to recover sums the liquidators claimed were due to Meadowside. Pythagoras's terms of engagement were undisclosed, save that it was to be paid a percentage of the amount recovered from Hill.

Pythagoras sought to recover sums from Hill by way of adjudication. Despite resistance from Hill, the adjudicator heard the case and decided that £26,000 was due to Meadowside. Pythagoras then brought TCC proceedings to enforce the decision against Hill.

Pythagoras offered a guarantee from itself as security for any costs incurred by Hill in resisting enforcement and/or successfully litigating to overturn the adjudicator's decision, including any adverse costs awarded against Meadowside.

The court considered the *Bresco* decision in detail and the extent to which there could be an exception to the general principle that a company in liquidation could not pursue adjudication to enforcement (in the face of a cross-claim by the other party). The court concluded that an exception to this general principle was likely to arise where:

- the adjudication brought or to be brought determines the final net position between the parties under the relevant contract,
- satisfactory security is provided in respect of the sum awarded in the adjudication and in respect of any adverse order for costs made against the company in liquidation,
- satisfactory security is a question of fact but it is likely to be a combination of an undertaking to the court to ring fence the sum, a third party guarantee or bond and / or ATE insurance, and
- any agreement to provide funding or security for the claim could not amount to an abuse of process.

Balancing these principles, the court refused summary judgement on the basis that there was not an adequate security in place and there was no real degree of certainty that should the guarantee be called Pythagoras would have the financial ability to pay. The court considered that strong security was required to allow the exception to apply, such as a payment into court, a bank guarantee, or an ATE insurance policy in relation to costs.

Another significant factor in the court's decision was the potential for Pythagoras' terms of engagement to be an abuse of process. As the terms had not been disclosed, the court could not determine whether they breached the Damages Based Agreements Regulations (2013) i.e. that Meadowside would not receive less than 50% of the recovered money. Assuming the regulations had been breached, there was a reasonable prospect that the terms were champertous and an abuse of process, although that could not be decided definitively due to the lack of disclosure.

Conclusions and implications

This decision appears to leave open the path for liquidators to use adjudication as a tool for recovering sums due to an insolvent company, subject to conditions as to security and the ability of third parties to pursue those rights on their behalf. It remains to be seen whether the conditions imposed by the court will be commercially acceptable to those considering such action in the future.

This decision also provides an interesting example of abuse of process being raised in relation to a funding agreement and makes it clear that the scope of the 2013 Regulations is not limited to funding agreements made in relation to court proceedings but also embraces adjudication proceedings themselves. Claims consultants will now need to review any damages-based funding practices and satisfy themselves that their agreements are compliant with the Regulations.

This is not likely to be the end of the discussion on these issues, as the decision in *Bresco v Lonsdale* is being appealed to the Supreme Court with a decision expected in 2020.

Reference

http://www.bailii.org/ew/cases/EWHC/TCC/2019/2651.html

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